TULSA FEDERAL
CREDIT UNION

MAY19'14 PM 1:43 BOARD

May 13, 2014

Mr. Gerard Poliquin
Secretary to the NCUA Board
1775 Duke Street
Alexandria, VA 22314

Dear Mr. Poliquin:

On behalf of Tulsa Federal Credit Union, I would like to provide the following comment letter for the official record regarding the National Credit Union Administration (NCUA) proposed risk based capital rule approved by the NCUA Board in January 2014. We appreciate the opportunity to provide our thoughts on this very far-reaching regulatory proposal and to express some of our concerns about the potential negative impact the proposed rule would have on credit unions if finalized in its current form. In addition, we would like to offer some suggested improvements that we believe would improve the rule for your consideration as you move forward in the rulemaking process.

*General Comments*

We support the development of a system/process to accurately assess the risk that a credit union has on its balance sheets. There is no doubt that the current "one size fits all" approach fails to adequately measure the risk profile of the individual credit union. Indeed, history has shown us that those credit unions who choose to be involved in more risky initiatives without adequate capital to support those initiatives can be catastrophic for that particular credit union, as well as costly to the entire industry through losses to the National Credit Union Share Insurance Fund (NCUSIF).

However, we are hard pressed to envision a reasonable scenario where one can compare the risk profile of the banking industry to the credit union industry and come away with the opinion that the balance sheet of most credit unions has a greater risk than that of a bank. Compared to the banking industry's 5 percent Tier 1 leverage requirement we believe our industry's current 7 percent net worth requirement is already more than necessary. The higher net worth requirement, combined with the regulatory and legal limitations that restrict credit unions from some of the riskiest types of lending and investments that are permissible at other financial institutions would, seem to indicate that whatever risks are on a credit union's balance sheet are more than adequately covered. In historical perspective comparing the losses of the banking industry versus those of the credit union industry, the adequacy of the current net worth system for credit unions is more than validated.

In fact, we have calculated our risk-based capital ratios under both the NCUA risk-based capital proposal and the Basel capital standards for community banks. Interestingly, our risk-based capital is higher under the Basel formula than the proposed regulation. In our opinion, there is something fundamentally wrong with a capital structure for institutions as unique as credit unions when their capital ratios would be better if they were community banks. We believe that the implementation of a regulation that places our industry at a disadvantage to the banking industry on the most fundamental issue of capital will increase the pressure from consultants and credit union leadership to investigate the advantage of a charter change. This regulation will be a "game changer" for the credit union industry, and we feel that its long term implications will be significant. We believe that it is vitally important for NCUA to take the necessary time to consider the longer term ramifications of these regulations and understand the concerns that will be expressed by the credit union industry before finalizing such a rule that the agency cannot, frankly, afford not to get right.

Once a final regulation is approved, it is equally important the NCUA allow the industry plenty of time to make the required changes to their balance sheet and re-evaluate the strategic direction of the credit union. Basel, which the banking industry operates under, took nearly four years to develop and banks were given three years to implement. Similarly, NCUA should take the time necessary to get this final regulation right and also provide the industry at least three years to make the required necessary adjustments to comply with this new regulation when finalized.

*Risk Weightings*

In general, any risk weighting approach that assigns a risk weight to a particular asset without considering the track record of the credit union ability to manage that risk seems to take into account only half of the equation. Credit unions that have demonstrated the ability to manage the type of business they are in should be given credit for that performance. In regards to any loan, the credit union's historical delinquency and charge-off rate of that particular loan product should be a variable in the determination of an appropriate risk weight. We believe that better than expected peer performance should equate to a lower risk weighting. Without recognizing the credit unions performance on these products, NCUA will surely, almost certainly, force credit union's that excel at a certain loan product to curtail or discontinue offering the product which may impact their ability to be competitive. This would ultimately impact profitability and the net worth growth.

The planned risk weights of the proposal compared to the risk weights that banks currently operate under indicates that there are a number of major differences where credit union assets have a significantly higher risk weighting. In fact, these unnecessary and incomparable differences are so significant that it inevitably places credit unions at a competitive disadvantage to banks. The chart below highlights the most significant of these differences.

| Category | Sub Category | NCUA Proposal | FDIC weights |
|---|---|---|---|
| | | | |
| Investments | 1 – 3 years | 50% | 20% |
| | 3 – 5 years | 75% | 20% |
| | 5 – 10 years | 150% | 20% |
| | > 10 years | 200% | 20% |
| Real Estate Loans | | | |
| | 25% - 35% of assets | 75% | 50% |
| | > 35% of assets | 100% | 50% |
| | | | |
| | Other R/E and delinquent R/E | | |
| | 10% - 20% of assets | 125% | 100% |
| | > 20% of assets | 150% | 100% |
| | | | |
| Other Loans | MBLs | | |
| | 15% -25% of Assets | 150% | 100% |
| | > 25% of Assets | 200% | 100% |

Interestingly, the proposed regulation risk weights real estate loans less than mortgage backed securities. This is quite odd since, unlike a mortgage loan, there is essentially no credit risk on a permissible mortgage backed security. Further, the interest rate risk profile of a mortgage loan compared to a mortgage back security will likely be very similar. If there is less credit risk exposure to the credit union and the interest rate risk profile is nearly the same, why wouldn't the risk weighting on a mortgage backed security be lower or at least the same as a credit union originated mortgage loan?

Based on the current permissible investments there is little, if any, credit risk that credit unions are putting on the balance sheet so we must assume that NCUA is concerned about interest rate risk. Attempting to control interest rate risk via this regulation, in our view, is too simplistic, seems redundant and ultimately unnecessary.

To illustrate, based on the current market prepayment assumptions of a mortgage backed security it is possible that the weighted average life (WAL) of a mortgage backed security to fluctuate on a monthly basis. As a result of a slowdown in the current month's market based prepayment assumptions, a security with a weighted average life (WAL) of 4.6 years could easily extend to slightly over five years requiring a risk weighting of 150 percent versus 75 percent. Only to have the following month's market based prepayment assumptions speed up thereby reducing the WAL to below five years requiring a risk weighting of 75 percent. With the possibility of this fluctuation, the risked-based capital ratio would change month to month. Additionally, the risk weighting of a security with a WAL of 5.1 years should not be assigned the same risk weighting as a security with a WAL of 10 years.

Obviously, there is greater interest rate risk exposure with longer term investments but we believe that this issue is best managed within the current credit union regulations, the credit union's Asset Liability Management (ALM) policy, credit union's Investment Policy and ultimately the results of ALM modeling. As a result, we believe that the same risk weighting should be assigned to investments regardless of the term of the investment. In addition, we find it hard to understand why the risk weighting on such an investment should ever be in excess of 100%, regardless of term or concentration, as the most that can be lost in the absolute – and totally impossible to actually happen - worst case scenario is the entire amount of the investment itself (100%) could be at risk.

Moving on to consumer lending, the proposed regulation assigns a 75 percent risk weight on all non-mortgage consumer loans. There is a very different risk profile between secured loans and unsecured loans. Therefore, secured consumer loans should have a lower risk weight.

Since the current Call Report does not differentiate between cash on deposit at banks and cash on deposit at the Federal Reserve, the proposed regulation risk weights cash on deposit at the Federal Reserve at 20 percent. That is inconsistent with how U.S. Government obligations directly and unconditionally guaranteed by the U.S. Government receive a risk weighting of zero percent. We assume that the Call Report will be modified to address this issue.

Regarding real estate loans, we suggest that NCUA include other variables in the determination of a proper risk weighting. As previously mentioned, historical delinquency and historical charge-offs need to be considered. Additionally, a lower risk weighting should be assigned to shorter term mortgages and adjustable rate mortgages. A 15-year mortgage does not present the same level of risk compared to a 30-year mortgage. Similarly, adjustable rate mortgages do not present the same interest rate risk as fixed rate mortgages. Therefore, in order to adequately recognize the different risk profile, we believe that a lower risk weighting should be assigned to adjustable rate mortgages.

Without consideration of the purpose of a CUSO, assigning a 250 percent risk weighting to CUSOs appears to be arbitrary. This would seem to suggest that the mere existence of a CUSO creates a greater risk to a credit union than any other area of investment, lending or operation. In reality, it is the business that the CUSO is involved in which contributes to the risk profile. Case in point, it is highly unlikely that a CUSO with the purpose of originating commercial loans would have the same risk profile as a CUSO which sells automobile and home insurance.

Further, many CUSO's are created to share operating expenses or reduce/share risk across multiple credit unions. This collaborative business model would likely be in jeopardy due to a 250 percent risk weighting. It is also interesting that the risk weighting is based on the current value of the investment in the CUSO versus the credit union's initial investment. The increase in the value of the initial investment does not negatively impact the risk profile of that investment. In fact, it improves the risk profile of the investment. The risk weighting should be based on the initial investment, and that risk weighting should be reduced if that market value improves.

*Examiner Discretion*

In our opinion, an established and unmovable risked-based capital ratio is essential for us to be able to manage effectively. The ability of an examiner to arbitrarily (and it will indeed be considered by credit unions to be arbitrary, regardless of the justifications cited by the examiner) require a higher risked-based capital ratio when the credit union had already met the requirement is unacceptable and inconsistent with the purpose of this regulation which is to provide understandable risk based capital criteria to which credit unions can manage their balance sheets. We strongly encourage NCUA to establish a clear objective rule to which the industry can manage and keep any potentially subjective variability out of the compliance equation.

*Supplemental Capital*

We believe that a supplemental capital provision should be included in this regulation and, upon its inclusion, the entire regulation re-published for further comment. Even though we recognize that supplemental capital cannot be considered for statutory PCA net worth ratio, we do not believe that any legal restriction exists that prohibits it from being considered for a regulatory Risked-Based Capital Ratio. We encourage NCUA to develop regulation that permits supplemental capital for credit unions in the form of subordinated debt from its members.

Although our industry has had a few – and only a few - high profile credit union problems during the past five years, which occurred in large part due to the severe economic downturn our country went through, it pales in comparison to the number of problems within the banking industry. (For example, FDIC reports that 485 bank failures occurred between 2008 and 2012). We believe that this difference is primarily due to less risk on a credit union balance sheet. So, after the credit union industry performed quite well and emerged relatively unscathed after going through the worst economic downturn that this country has experienced in over a hundred years, we do not understand why NCUA believes that our industry needs a sweeping overly restrictive risk-based capital regulation?

We support the efforts of NCUA to pursue a balanced risk-based capital system that requires additional capital of truly higher risk credit unions even as it rewards those credit unions with proven risk management evident in a lower risk balance sheet. While we do not believe the current proposal is sufficiently balanced and should be withdrawn in its entirety if it cannot be perfected, we respectfully encourage NCUA to consider some of our recommended improvements to the proposal. With the right changes, this rule can become a source of long term viability of the credit union charter. For the long term viability of the credit union charter, we hope the agency takes the time to get it right.

If I can be a source of any further information on this comment letter, please do not hesitate to contact me.

Sincerely,

Gregory W. Gallant
President & CEO

CC: The Honorable Jim Bridenstine
The Honorable Tom Coburn
The Honorable James M. Inhofe